

Brigham Young University Department of Economics
Economics 110 – Principles of Economics
Professor Kerk Phillips - Winter Semester 2002, section 4

Midterm #4 key

(answers at the end)

4/8 - 4/9

4/10 with Late Fee

This test is multiple choice, fill in your answers on the scantron sheet and do not write on this exam. It is closed book and closed notes. There is no time limit and you may use the calculators provided by the testing center if you wish. Read all questions carefully before answering. If you feel that more than one answer is or could be correct, then mark the one which is most correct.

1) The aggregate demand curve holds constant all of the following EXCEPT

- A) tax rates.
- B) investment demand.
- C) the money supply.
- D) the price level.
- E) none of the above.

2) Which of the following would increase aggregate demand at all levels?

- A) A decrease in the money supply.
- B) An increase in government spending.
- C) A decrease in tax rates.
- D) An increase in consumers' saving rates.
- E) none of the above.

3) Assuming some wage stickiness in the short run, if the aggregate demand curve shifts to the right

- A) both the price level (P) and real GDP increase.
- B) both P and real GDP fall.
- C) P rises, but real GDP remains the same.
- D) P falls and real GDP rises.
- E) none of the above.

4) According to the quantity theory of money, if the supply of money is increased more than demand is increased,

- A) the value of money should rise.
- B) the price level may go up or down.
- C) the price level should fall
- D) the price level should rise.
- E) none of the above.

5) The technical definition of M1

- A) includes small time deposits.
- B) includes money-market mutual funds.
- C) includes money-market mutual funds.
- D) includes savings and small time deposits.
- E) includes none of the above.

6) The distinguishing characteristic of fiat money is that

- A) its value as a good exceeds its value as money.
- B) governments typically have a monopoly on its production.
- C) it can be produced by private individuals.
- D) its value as a good is less than its value as money.
- E) none of the above.

7) The function of the Federal Open Market Committee (FOMC) of the Federal Reserve is

- A) advising the Senate on monetary issues.
- B) controlling the money supply.
- C) buying computer services for the Fed.
- D) printing money.
- E) none of the above.

8) The Board of Governors of the Federal Reserve System consists of

- A) the presidents of each Federal Reserve Bank.
- B) 12 members appointed by Congress.
- C) 5 members appointed by the President and 2 elected members.
- D) 7 members appointed by the President.
- E) none of the above.

9) Assuming banks do not wish to hold excess reserves and that there are no cash leakages, if the required-reserve ratio against demand deposits is 10 percent, the deposit multiplier is equal to ____.

- A) 5
- B) 10
- C) 0
- D) 20
- E) none of the above.

10) Which of the following correctly defines the components of the monetary base?

- A) Reserves at the Fed, vault cash and currency in circulation.
- B) M1 plus M2.
- C) Currency in circulation and checkable deposits.
- D) Government bonds and bank loans.
- E) none of the above.

11) When the Fed purchases government securities on the open market,

- A) currency in circulation increases, and the monetary base decreases.
- B) bank reserves and the monetary base increase.
- C) bank reserves increase, and the monetary base decreases.
- D) bank reserves decrease, and the monetary base increases.
- E) none of the above.

12) The most important day-to-day tool of the Fed's monetary policy is

- A) buying and selling government securities.
- B) controlling bank loans through moral suasion.
- C) controlling the reserve requirements.
- D) controlling the discount rate.
- E) none of the above.

13) Which of the following is correct? The Fed directly controls

- A) currency in circulation and demand deposits.
- B) currency in circulation only.
- C) demand deposits only.
- D) the monetary base.
- E) none of the above.

14) Automatic stabilizers refer to

- A) deficit-reduction policies.
- B) the unemployment effects of recession.
- C) discretionary fiscal policies.
- D) government spending actions that tend to automatically dampen the business cycle.
- E) All of the above.

15) Suppose the natural rate of unemployment is 6% and that the actual rate of unemployment is 4%. The federal government has a deficit of \$40 billion this year. Tax revenues would have been \$20 billion lower and transfer payments would have been \$20 billion higher at full employment. The structural deficit is _____ billion.

- A) \$0
- B) - \$60
- C) - \$40
- D) - \$80
- E) none of the above.

16) The federal debt is best defined as

- A) the cumulative sum of annual federal deficits and surpluses.
- B) the sum of all annual off-budget expenditures.
- C) the net lifetime obligations of benefits from federal taxes and expenditures.
- D) the annual difference between federal revenues and expenditures.
- E) none of the above.

17) Supply shocks and demand shocks can both cause inflation. The persistent inflation since the 1930s is thought to be the result of demand shocks

- A) caused by random changes in private investment.
- B) stemming from wars, technological innovations, increases in oil prices, and slow down in the growth of labor productivity.
- C) due to substantial growth of the money supply.
- D) caused by major changes in the tax code for individuals and businesses.
- E) none of the above.

18) Empirical data on post-WWII inflation in the United States shows that

- A) inflation has risen and fallen.
- B) inflation and interest rates are negatively correlated.
- C) there is a strong negative correlation between the rate of growth of the money supply and the rate of inflation.
- D) inflation has been steady at about 5 percent per year.
- E) none of the above.

19) Which of the following is correct? In a pure supply-side inflation,

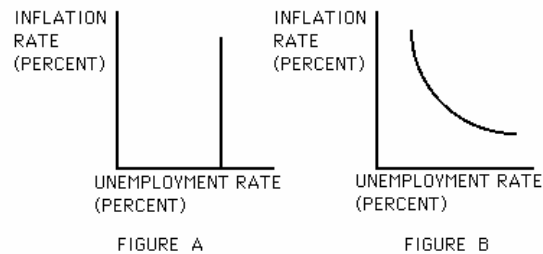
- A) the price level rises and real GDP declines.
- B) the price level and real GDP both increase.
- C) only real GDP changes while the price level remains constant.
- D) All of the above.
- E) none of the above.

20) For job searchers, the higher their reservation wage,

- A) the more rapidly will inflationary expectations change.
- B) the more it is likely that wages throughout the economy are sticky, as predicted by Keynes
- C) the longer the period of job search before an employment offer is accepted.
- D) the greater will be the natural rate of unemployment.
- E) none of the above.

21) Economists believed in the stable tradeoff between inflation and unemployment demonstrated by A.W. Phillips until the 1970s and 1980s. The new empirical evidence that stimulated a reformulation of Phillips' concept showed that

- A) a large proportion of unemployment was frictional in nature.
- B) investment spending was much less sensitive to changes in the interest rate than had been previously believed.
- C) a long and variable lag for monetary policy was the most likely explanation for inflation.
- D) high rates of inflation and unemployment could simultaneously occur.
- E) none of the above.



22) Which of the diagrams above best illustrates the results of A.W. Phillips' research into the relationship between unemployment and the rate of change of inflation?

- A) Figure A.
- B) Figure B.
- C) Neither Figure A nor Figure B.
- D) Both Figure A and Figure B.

23) The Keynesian explanation of the business cycle rests on several concepts, including

- A) the desire of politicians to be re-elected.
- B) sticky wages.
- C) random shocks to the rate of technological change.
- D) unstable money demand.
- E) none of the above.

24) Monetarist reasons for following a constant-monetary-growth rule include all of the following EXCEPT that

- A) activist policies can aim for the wrong targets.
- B) policy-makers cannot accurately predict a recession.
- C) the effects of fiscal policy are uncertain.
- D) there are short lags in the effect of money on GDP.
- E) none of the above.

25) The inability of macroeconomists to find one all-encompassing theory of business cycles may indicate that

- A) the Chairman of the Federal Reserve, whose actions greatly influence U.S. business cycles, cannot be "modeled."
- B) real-world business cycles have a multiplicity of causes.
- C) macroeconomists have some wonderful theories, but none of them are very practical.
- D) the implementation of various activist policies in the United States have made testing for the causes of business cycles nearly impossible.
- E) none of the above.

26) "A Monetary History of the United States: 1867-1960" was written by:

- A) Milton Friedman and Franco Modigliani.
- B) Franco Modigliani and Anna Schwartz.
- C) Milton Friedman and Anna Schwartz.
- D) Milton Friedman, Franco Modigliani and Anna Schwartz.
- E) None of the above answers are correct.

27) James Buchanan is an important member of the following school of thought:

- A) Monetarism.
- B) Rational Expectations
- C) Neo-Keynesian.
- D) Public Choice.
- E) None of the above.

28) John Muth's 1961 paper was the basis around which younger economist such as Robert Lucas and Thomas Sargent built which school of thought?

- A) Monetarism.
- B) Rational Expectations
- C) Neo-Keynesian.
- D) Public Choice.
- E) None of the above.

29) The notion that "econometric models are obsolete because they are based on past data and statistical models cannot predict the effect of new government", is called

- A) The Lucas Critique.
- B) Adaptive Expectations.
- C) Neo-Keynesianism.
- D) The Volcker Hypothesis.
- E) None of the above.

30) Which of the following is associated with the Public Choice school?

- A) Milton Friedman
- B) Robert Lucas
- C) John Maynard Keynes
- D) George Stigler
- E) None of the above are.

Answers

- 1) D
- 2) C
- 3) A
- 4) D
- 5) E
- 6) D
- 7) B
- 8) D
- 9) B
- 10) A
- 11) B
- 12) A
- 13) D
- 14) D
- 15) D
- 16) A
- 17) C
- 18) A
- 19) A
- 20) C
- 21) D
- 22) B
- 23) B
- 24) D
- 25) B
- 26) C
- 27) D
- 28) B
- 29) A
- 30) D